MOTION FILED
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IN THE

Supreme Court of the United States

OCTOBER TERM, 1976

No. 75-1687

UNITED STATES TRUST COMPANY OF NEW YORK, as Trustee for the Port Authority of New York and New Jersey Consolidated Bonds, Fortieth and Forty-First Series, on its own behalf and on behalf of all holders of Consolidated Bonds of The Port Authority of New York and New Jersey and all others similarly situated,

Appellant,

v.

THE STATE OF NEW JERSEY, BRENDAN T. BYRNE, Governor of the State of New Jersey, and WILLIAM F. HYLAND, Attorney General of the State of New Jersey,

Appellees.

ON APPEAL FROM THE SUPREME COURT OF NEW JERSEY

MOTION FOR LEAVE TO FILE REPLY BRIEF *AMICUS CURIAE* AND REPLY BRIEF *AMICUS CURIAE*

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November 5, 1976

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MOTION FOR LEAVE TO FILE REPLY BRIEF *AMICUS CURIAE*

The Securities Industry Association respectfully moves for leave to file the accompanying reply brief *amicus curiae* in the above-described action in response to the brief filed by appellees, The State of New Jersey, et al., and in further support of the appeal to this Court by appellant United States Trust Company of New York. Counsel for appellant and counsel for appellees have consented to the filing of a reply brief by the Securities Industry Association as *amicus curiae*.

The Securities Industry Association ("SIA"), through its Public Finance Division, has sought to file briefs as *amicus curiae* in this appeal on the ground, *inter alia,* that its vast wealth of collective experience in and expertise with respect to the municipal bond market made it singularly able to present facts relevant to and analyze arguments raised in this appeal.

On June 28, 1976 this Court granted SIA's motion for leave to file a brief *amicus curiae* in support of appellant's jurisdictional statement. On August 12, 1976 the SIA filed a brief *amicus curiae* herein on the merits with the consent of counsel for appellant and counsel for appellees. On November 5, 1976 the accompanying reply brief *amicus curiae* was timely submitted for filing along with the requisite consent of counsel for appellant and counsel for appellees, but was rejected by the Clerk of the Court.

The SIA makes this motion to file the accompanying reply brief *amicus curiae* on the grounds that such brief analyzes facts and questions of law not adequately presented by the parties in any of their briefs and that such brief was timely filed with the requisite consents pursuant to the advice of one of the assistant clerks of this Court.

I

There are Compelling Reasons Why *Amicus* Should be Permitted to Reply to Certain Arguments Raised For The First Time by Appellees.

The Brief for Appellees ("App. Br.") raises certain new arguments to which apellant has not responded, principally because appellant views the issues from a somewhat different perspective than that of *amicus.*

Thus, in the accompanying reply brief *amicus* makes the following points which have not been made by either of the parties in their briefs:

1. Appellees argue that the 1962 Covenant was superfluous because other bondholder protections were adequate, particularly the Section 7 certification requirement (App. Br. 92-95). This argument, however, is completely refuted by the undisputed fact that the Commissioners of The Port Authority of New York and New Jersey ("Port Authority") were able to make a Section 7 certification in connection with the takeover of the Hudson and Manhattan Railroad (now PATH), *only* by projecting that PATH's annual operating deficits would level off at approximtely $6,575,000 per year*, *which amount turned out to be only one-fifth of the actual present operating deficits of PATH.* (See accompanying reply brief of *amicus,* page 8, note 5, *supra.*) Obviously, without the 1962 Covenant the Port Authority would be free to take on or build another rail mass transit facility by making a Section 7 certification based on projected deficits which, even if made in good faith, with the erroneous PATH projections used as an example, will inevitably turn out to be a fraction of the actual annual deficits in the future. In such an event none of the other bondholder protections so heavily relied on by appellees, including the Section 7 certification, the 1.3 test and Section 12(f), would protect Port Authority bondholders from the acquisition of another rail mass transit facility with the perpetual, staggering and ever increasing deficits which characterize rail mass transit projects. (See accompanying reply brief of *amicus,* pages 9-11.)

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* "The Commissioners' 1962 certification made with respect to the acquisition of the PATH System was made on the basis of an opinion of A. Gerdes Kuhbach, the Director of Finance of the Port Authority, which was prepared at the request of the Commissioners. His opinion analyzed and reviewed the financial aspects and data relating to the proposed acquisition, rehabilitation and operation of the PATH System. *He concluded that the Section 7 certification could be made since the anticipated net loss after debt service for the years 1969 through 1991 would level off at approximately $6,575,000 per year, an amount that would not impair the sound credit rating of the Port Authority."* (Appendix p. 677; Stipulation among counsel dated December 20, 1974, p. 209. (emphasis added.))

2. Appellees' novel argument that a state may impair a contractual obligation under the guise of its police power *even in the absence of an emergency* (App. Br. 82-83), is refuted by a long line of Contract Clause decision of this Court, and is unsupported by the two decisions of this Court relied upon by appellees. (See accompanying reply brief of *amicus,* pp. 16-20, *infra.*)

3. No emergency existed sufficient to justify the impairment of the contract with Port Authority bondholders (see accompanying reply brief of *amicus,* pp. 20-22); and judicial deference ordinarily afforded legislative determinations is inappropriate in cases such as the one before this Court (id. at 22-23).

II

The Accompanying Reply Brief Was Properly Submitted on November 5, 1976.

The accompanying reply brief *amicus curiae* was timely submitted for filing along with the requisite consents of counsel on Friday, November 5, 1976, but was rejected by the Clerk of the Court.

Counsel for *amicus* submits that the brief was properly filed and should have been accepted. Rule 42 of the Revised Rules of this Court, as amended to November 15, 1975, provides in pertinent part:

> "2. A brief of an *amicus cruiae* in cases before the court on the merits may be filed only after order of the court or when accompanied by written consent of all parties to the case and presented within the time allowed for the filing of the brief of the party supported."

Amicus filed its reply brief and written consents in conformity with the rule on November 5, 1976, the date by which appellant was required to file its reply brief. Counsel

respectfully submits that a reply brief is a "brief" within the meaning of Rule 42.

Howard F. Husum, Esq., associated with counsel for *amicus,* called the office of the Clerk of the Court on November 1, 1976, and was advised that the procedure for filing a *reply* brief *amicus curiae* was the same as for filing an initial brief—by motion or on consent of counsel. (See the affidavit of Howard F. Husum, Esq., sworn to on November 8, 1976, annexed hereto as Exhibit "A.") However, on November 5, 1976, the Clerk of the Court called counsel for *amicus* and advised that its reply brief was being rejected on the ground that the rules of this Court do not provide for the filing of reply briefs by anyone other than the parties.

There is absolutely no indication in the Rules of this Court that reply briefs may be filed only by the parties. Rule 40 provides in pertinent part:

> "4. Reply briefs shall conform to such portions of this rule as are applicable to the briefs of an appellee or respondent, but need not contain a summary of argument, regardless of their length, if appropriately divided by topical headings."

While it is understandable why this Court would seek to discourage the filing of reply briefs by *amicus,* thus avoiding a proliferation of redundant briefs, it is respectfully urged that the accompanying reply brief of *amicus* should be accepted by this Court in that it contains an analysis of certain key issues not discussed by the parties in their brief and would thus be of assistance to this Court in reaching its decision. The acceptance of the accompanying brief is also urged on the additional, albeit less compelling ground that counsel for *amicus* expended the effort and expense of preparing such brief in reliance on the advice obtained from the office of the Clerk of the Court.

Filing of the accompanying reply brief today cannot work any prejudice on the parties for the reason that copies of said brief were mailed and hand delivered to them on Friday, November 5, 1976, and counsel for all parties have consented to the filing of a reply brief by *amicus*.

Respectfully submitted,

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Attorneys for
Securities Industry Association

Of Counsel:

PHILIP R. FORLENZA
HOWARD F. HUSUM
HAWKINS, DELAFIELD & WOOD

November 8, 1976

EXHIBIT "A"

Affidavit of Howard F. Husum

HOWARD F. HUSUM, being duly sworn, deposes and says that he is associated with Hawkins, Delafield & Wood, counsel to the Security Industry Association and fully familiar with the facts and proceedings heretofore had herein.

1. This affidavit is submitted in connection with the accompanying motion for leave to file a reply brief *amicus curiae*.

2. On November 1, 1976, your deponent called the Office of the Clerk of the Supreme Court of the United States and asked to speak to Mr. Michael Rodak, Jr., the Clerk of the Court, in regard to the filing of a reply brief *amicus curiae* by the Securities Industry Association in the "Port Authority" case.

3. Your deponent was connected with someone he assumed was Mr. Rodak. However, snice Mr. Rodak has advised your deponent that he did not participate in any such conversation, your deponent must have been speaking to one of Mr. Rodak's male assistants. This individual confirmed that a reply brief could be filed by *amicus*, stating that since the Rules of the Court were silent on the point the procedure for filing a reply brief *amicus curiae* was the same as that for filing an initial brief *amicus curiae* —by motion or on oconsent of the parties.

HOWARD F. HUSUM

Howard F. Husum

Sworn to before me this
8th day of November, 1976

DOROTHY M. FALLEO

Notary Public

DOROTHY M. FALLEO
Notary Public State of New York
No. 41-6227510
Qualified in Queens County
Certificate Filed in New York County
Commission Expires March 30, 1978

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REPLY BRIEF OF AMICUS CURIAE

The Securities Industry Association, through its Public Finance Division, respectfully submits this brief in response to the brief filed by appellees, The State of New Jersey, et al., and in further support of the appeal to this Court by appellant United States Trust Company of New York. Counsel for appellant and counsel for appellees have consented to the filing of a reply brief by the Securities Industry Association as *amicus curiae.*

ARGUMENT

I

The 1962 Covenant Was a Relied Upon and Bargained For Part of the Bond Contract Between Bondholders and the Port Authority.

The 1962 Covenant provided in unequivocal terms that:

> "The 2 states covenant and agree with each other and with the holders of any affected bonds, as hereinafter defined, that so long as any of such bonds remain outstanding and unpaid and the holders thereof shall not have given their consent as provided in their contract with the port authority, . . . neither the states nor the port authority nor any subsidiary corporation incorporated for any of the purposes of this act will apply any of the rentals, tolls, fares, fees, charges, revenues or reserves, which have been or shall be pledged in whole or in part as security for such bonds, for any railroad purposes whatsoever other than permitted purposes hereinafter set forth." (A 10-11)[1]

There can be no doubt that, from the time of the enactment of the Covenant in 1962 until its retroactive repeal in 1974, purchasers of Consolidated Bonds of The Port Authority of New York and New Jersey ("Port Authority") relied upon the Covenant as an integral part of their bond contract with the Port Authority—as a protection against the addition of deficit mass transit facilities into the Port Authority's credit structure and the consequent weakening of such structure.

The Covenant was described and discussed in every Official Statement of the Port Authority disseminated in connection with the offer and sale of Port Authority Consolidated Bonds ("Consolidated Bonds") since 1962.[2] Typically, the Official Statements stated in relevant part:

> "In connection with the legislation which authorized the Port Authority to assume responsibility for the Hudson Tubes system, the Port Authority had advised the Legislatures of both States that the credit of the Port Authority would be impaired by such an undertaking of an anticipated perpetual deficit facility unless the States would enter into an enforceable contract with the Port Authority bondholders which would grant assurances against dilution of already pledged revenues and reserves by any additional passenger rail deficits beyond those of the basic Hudson Tubes system. The legislation as finally adopted includes such statutory covenants. The covenants are between the two States and with the holders of certain described 'affected' bonds which include all Consolidated Bonds including those of the present offering. The contract prohibits the application of any revenues or reserves pledged to such bonds * * * for any additional passenger railroad purpose beyond the basic Hudson Tubes, as defined, without the consent of the holders of such affected bonds as provided in their contract with the Authority unless the Port Authority shall have first certified the eligibility of such additional railroad, whether it be a Hudson Tubes extension, as defined, or new railroad facility. To be eligible the Port

1. "A" references are to the Appendix submitted to this Court.

2. An Official Statement is used in offerings of municipal securities for the same purposes as prospectuses are used in offerings of corporate securities, *i.e.*, to induce the purchase of securities by those prospective purchasers who read the offering material. Although offerings of municipal securities are not subject to the registration requirements of the federal securities laws, such offerings are subject to the anti-fraud provision of such laws. Such Official Statements should "accurately reflect all material facts which a prudent investor should know in order to evaluate the offering before reaching an investment decision." *In the Matters of Walston Co., Inc., and Harrington*, Securities Exchange Act Release No. 8165 (1967) CCH Fed. Sec. L. ¶77,474. It is beyond peradventure that the description of the Covenant was an important inducement to prospective purchasers necessary for them to know in order to evaluate the offering before reaching an investment decision.

> Authority must determine either that the proposed additional passenger railroad facility is self-supporting or, if not, that at the end of the preceding calendar year the General Reserve Fund contained the full statutory amount and that for the ensuing ten years the estimated average annual deficits from the proposed additional passenger railroad facility and any then existing Port Authority passenger railroad facility (including the basic Hudson Tubes) would not in the aggregate exceed an amount equal to one-tenth of the amount in the General Reserve Fund at the prior year end. • • • Section 6 of the 1962 legislation (see Appendix III) should be studied for the exact terms of the statutory covenant." (A 17)

The Superior Court itself acknowledged that investors relied on the 1962 Covenant in purchasing Consolidated Bonds:

> "Based upon the testimony offered by plaintiff, the investment community's understanding of the covenant was that it in some manner furnished 'security for the bondholders and it protected the diversion of the earnings of the Port Authority into deficit mass rail transit.' If the covenant is to be understood in that sense, the record supports plaintiff's claim that investors relied on the covenant in purchasing Authority bonds." (A 110)

Although the Superior Court conceded such reliance it concluded that "while reliance existed" the Covenant was not the "primary consideration" for the purchases because

> "no witness testified that purchases would *not* have been made without the covenant, but only that they would not have purchased or recommended the purchase of the bonds 'at the price which they were then offered.'" (A 110)[3]

3. It is hard to understand how the Superior Court could have reached this conclusion after having only a few pages earlier in its opinion noted that "the interest rate fixed when [revenue] bonds are initially marketed, as well as the price of the bonds in the secondary market, will normally reflect the investor's evaluation of the underlying security of his investment. . . ." (A 108)

This conclusion by the Superior Court, more than anything else, dramatizes the basic error in the Court's reasoning. The conclusion is not consistent with the realities of the credit markets. As the gravity or number of risks related to a security increases the interest rate required to induce the purchase of such security must be raised. It may be that the security would not be purchased at any rate because the risks are just too great, but such a state of facts hardly ever exists. In any event, the types of prospective purchasers of any security change as risks and rates change because some purchasers are rate oriented and some are risk oriented. Thus, the Superior Court failed to understand the nature of debt offerings. Such securities are offered (with known or potential risk factors) at a particular price and interest rate; based on such risk factors and such interest rates, the prospective purchasers then decide either to purchase or not to purchase the security at the stated purchase price. If one ingredient of one equation is changed, the others naturally will change. It follows that the Consolidated Bonds would not have been purchased at the rates and prices incident to the original transactions but for the existence of the Covenant; and appellants witnesses so testified.[4]

Thus, there can be no doubt that the Covenant was a "bargained for" element of the bond contract into which

4. In their brief appellees state that the "appellant's claim that the price purchasers were willing to pay for bonds was affected by the covenant is unsupported by the record and immaterial as a matter of law." Appellees' Brief 89 (hereinafter cited as "App. Br."). However, no support is given for such statement, and only two pages later appellees try to suggest that strong testimony of the appellant's witnesses on this point was hypothetical. App. Br. 91. In fact each of the witnesses who testified with respect to such matters clearly testified that he would not have purchased the bonds at the prices paid without the existence of the Covenant. (A 873, 1105). Mr. Gordon Fowler, for example, whom appellees incorrectly quote, App. Br. 16, testified: "I can't say for certain we would not have purchased them, but if we had, if would have been at a much lower price for the given coupons". (A 1105)

private purchasers entered—in the sense that investors would not have purchased Consolidated Bonds at the same rates in the absence of the Covenant. The Covenant was that part of the bond contract wherein purchasers contracted against the economic fear, if not the economic certainty, that further Port Authority involvement in deficit mass transit would diminish the amount of security available to pay their bonds, either immediately or in the long run. Indeed, the *express* purpose of the Covenant was to preclude the *possibility* of the diminution of security by reason of the financing of deficit rail mass transit.

That the 1962 Covenant was enacted for the specific purpose of *inducing* investors to continue to purchase bonds of the Port Authority is beyond question and was acknowledged by the Superior Court:

> "'[T]he fact of the matter is that the Legislature of 1962 concluded it was necessary to place a limitation on mass transit deficit operations to be undertaken by the Authority in the future so as to promote continued investor confidence in the Authority.'" (A 109)

Thus, the instant case is unlike the situation in *El Paso* v. *Simmons,* 379 U.S. 497, 514 (1965), in that Port Authority bondholders *were* "substantially induced to enter into these contracts" on the basis of the 1962 Covenant.

Indeed, it would be difficult to conceive of a Contract Clause case that has as little to do with the question of the constitutionality of a sovereign's attempt to repudiate its solemn promise made to induce bondholders to lend it money than the *El Paso* case. In *El Paso,* the party objecting to the state legislation was a rank *speculator* who lacked whatsoever any *bargained-for* contractual claim worthy of protection; he was also, at the time of suit, in possession of an interest in a piece of land that had been forfeited to the state more than five years previous on

account of a *default* in interest payments. This Court was not unaware of the tenuous thread on which plaintiff's claim dangled:

> "We, like the Court in *Faitoute Iron & Steel Co.* v. *City of Asbury Park,* 316 U.S. 502, 514, believe that '[t]he Constitution is intended to preserve practical and substantial rights, *not to maintain theories.*'" • • •
>
> • • •
>
> "The five-year limitation allows *defaulting* purchasers with a *bona fide* interest in their lands a reasonable time to reinstate. It does not and need not allow *defaulting* purchasers with a *speculative* interest in the discovery of minerals to remain in *endless default* while retaining a cloud on title." 379 U.S. at 515 (emphasis added).

Clearly, the doctrinal considerations employed by this Court in *El Paso* to defeat the claim of a defaulting speculator have absolutely no bearing under the facts of this case where the legitimate contractual rights of non-defaulting bondholders are at stake.

El Paso is obviously not a case for all seasons. It is a decision grounded on a narrow and unique fact pattern and should not be applied indiscriminately to deprive bondholders of their constitutionally-protected contract rights. Appellees' contention to the contrary only betrays the weakness of their case.

II.

The Covenant Provided A Substantial Protection to Port Authority Bondholders.

Investor concern in 1962 over the proposed Port Authority takeover of a perpetual deficit rail mass transit facility was well founded. In 1962, when the Port Authority was asked to assume ownership and operation of the Hudson & Manhattan Railroad ("H & M"), (now PATH), the deficit for

such operation was expected to be about $5,000,000 per year initially (A 630), and to level off at approximately $6,575,000 per year during the years 1969 through 1991 (A 677).[5] Even if those projections had been accurate, which they were not, the anticipated losses were astronomically higher than those of any other Port Authority deficit facility. Thus, as of December 31, 1960 the Port Authority's largest deficit facility (Newark Airport) incurred an annual loss of only $527,000 (A 691). PATH's present annual losses are more than five times the anticipated amount, and dwarf the operating losses of the few other Port Authority facilities which operate at a deficit. For example, in 1973 PATH's operating deficit was approximately $18,000,000 (its total deficit for 1973 was almost $25,000,000 including debt service), whereas the combined annual net operating losses of the other three deficit facilities of the Port Authority in 1973 totalled a mere $1,009,000 (A 737).[6] To put the matter in further perspective, to date Port Authority losses attri-

5. At A 677, the excerpt from the Stipulation among counsel dated December 20, 1974 refers to pages 201-209 of said Stipulation, the entire text of which is contained in Volume IV of the Joint Appendix (cited as "Ja") submitted to the Supreme Court of New Jersey. It is stated on page 209 of said Stipulation that:

> "The Commissioners' 1962 certification made with respect to the acquisition of the PATH System was made on the basis of an opinion of A. Gerdes Kuhbach, the Director of Finance of the Port Authority, which was prepared at the request of the Commissioners. His opinion analyzed and reviewed the financial aspects and data relating to the proposed acquisition, rehabilitation and operation of the PATH System. He concluded that the Section 7 certification could be made since the anticipated net loss after debt service for the years 1969 through 1991 would level off at approximately $6,575,000 per year, an amount that would not impair the sound credit rating of the Port Authority."

6. Appellees erroneously state that in 1973, 14 of the 22 facilities operated by the Port Authority were operated at a deficit. App. Br. 34, n. 22. As is clear from the table at A 737, only three of such facilities, other than PATH, operated at a deficit; one of which had an annual deficit of only $1,000.

buted to the takeover and operation of PATH total, conservatively, over $125,000,000 (A 681).

Moreover, the PATH deficits were not only expected to be staggering, but perpetutal. This reversal of the Port Authority's long-standing policy of operating only those facilities which it could reasonably expect would eventually become self-supporting exacerbated investor concern. As was testified to by appellant's witness John F. Thompson, Vice President of W. H. Morton & Co.:

> "[M]y reaction to the Port Authority getting into that [the Hudson and Manhattan] or other mass transit was one of concern because the Port Authority has always gone into projects which it could reasonably ascertain that they would become self-supporting, at least within a period of a few years of development and this seemed to be a different tact [sic] for the Port Authority to start on." (A 855)[7]

Appellees contend that repeal of the 1962 Covenant deprived bondholders of an interest of little or no value. App. Br. 92-95. Of course, appellees undermine this contention

7. Appellees state that Mr. Thompson was either "thoroughly misinformed" or "ignorant" of the Port Authority's history of successfully carrying deficit facilities. App. Br. 33-34, 35. This argument is both unfounded and misses the point. Mr. Thompson testified that the Port Authority had always undertaken projects which it *expected* would *eventually* become self-supporting (see A 959), and this statement is in no way rendered inaccurate by the fact that certain facilities did not become self-supporting as soon as expected. In marked contrast, the H & M was never expected to become self-supporting, it was an acknowledged perpetual deficit facility. Moreover, it is preposterous for appellees to attempt to compare the huge annual deficits of the H & M and other rail mass transit operations to the deficits of those few facilities of the Port Authority which operated at a deficit for a period of time. The annual deficits of these few facilities were marginal and when compared to H & M deficits were infinitesimal. (See A 737, 691). The point is that a single rail mass transit project, with its staggering and perpetual deficits, affects the Port Authority's credit structure in a significant manner, whereas the minor operating deficits of other Port Authority projects, which have taken somewhat longer than expected to become self-supporting, do not affect the Port Authority's credit structure.

themselves by acknowledging that only by repeal of the Covenant can many millions of dollars be diverted to rail mass transit. App. Br. 60. Moreover, the argument that the 1962 Covenant gave investors no additional protection is patently absurd and ignores the basic characteristics of rail mass transit deficits—they are staggering, perpetual and incapable of accurate projection. Neither the Section 7 certification, the 1.3 test nor Section 12(f), individually or taken together, gives the bondholders the protection afforded by the 1962 Covenant.

In 1962, the Port Authority Commissioners were able to issue a certification under Section 7 that the takeover of the H & M would not "materially impair the sound credit standing of the Authority or the investment status of Consolidated Bonds or the ability of the Authority to fulfill its commitments" because of the projection that its net loss after debt service for the years 1969 through 1991 would level off at approximately $6,575,000 per year (A 677; see note 5, page 8, *supra*). That prediction was woefully inaccurate. Annual net operating deficits for PATH have now increased to over $30,000,000 per year. So much for the protection afforded by the Section 7 certification.

As to the 1.3 test, Daniel B. Goldberg, General Solicitor of the Port Authority, has noted (in a statement quoted by appellees, App. Br. 28) that "the 1.3 status is not prosperity to us; it is practically the point of enforced stagnation. It is the point at which our ability to finance any future projects, even any capital improvements of existing facilities, ceases." (A 836) So much for the protection afforded by the 1.3 test.

The Port Authority's experience with PATH can easily be repeated now that the 1962 Covenant has been repealed. The Port Authority will be free to take on or build another rail mass transit facility by having the Commissioners make a Section 7 certification based on *projected* deficits which will inevitably turn out to be a fraction of the actual deficits. The 1.3 test, even if met, would do no more than insure

investors that at best the Port Authority would be at a point of enforced stagnation.

As to Section 12(f)—which requires the Port Authority to establish and collect tolls, flight fees and other charges so as to generate sufficient revenue to provide for debt service upon all Consolidated Bonds—appellees state: "To take over or build a facility that would impose deficits so large that increases in tolls and charges could not carry them would violate Section 12(f). . . ." App. Br. 25. This argument is, at best, naive. If the Port Authority takes over or builds another rail mass transit facility whose deficits eventually grow to more than five times the projected amounts (as with PATH), it will be realized only in hindsight that Section 12(f), as well as Section 7, and possibly even the 1.3 test, were violated. After the fact recriminations and apologies will afford Port Authority bondholders little solace and no protection.

The indisputable fact is that in 1962 bondholders required protection in addition to that afforded by Section 7, the 1.3 test and Section 12(f) in view of the Port Authority's proposed takeover of the H & M. Investors realized that the day could come when the Port Authority fell on hard times, such as during the Depression when its toll revenues were inadequate (A 820), and in such a situation might not be able to carry two or more rail mass transit deficit operations with operating losses running into forty, fifty or sixty million dollars per year. The bondholders required assurances against such an eventuality and New Jersey and New York gave them that assurance—a solemn pledge in the form of the 1962 Covenant—in order to enable the Port Authority to take over the H & M.

Today, having abrogated that solemn pledge appellees argue that bondholders did not actually seek the protection of the Covenant and that the Covenant was really not very important. It is clear from the foregoing, however, that the Covenant was and continues to be an important protection to bondholders. In any event, appellees are asking this Court to second guess the 1962 legislature which deter-

mined that the Covenant was essential in order to continue to sell Consolidated Bonds and have the Port Authority take over the H & M—both goals being vital to the two states.

III.

Repeal of the Covenant Was an Egregious Impairment of Contract.

Appellees have failed to respond to the principal argument made by *amicus, to wit,* that New Jersey abrogated a covenant which its legislature had enacted for the specific purpose of inducing investors to purchase bonds of one of its corporate instrumentalities. That fact distinguishes this case from all other impairment cases which have come before this Court. Appellees do not attempt to refute this point simply because they could not do so. This Court has never before been asked to decide a case where the impairment of a contract was so egregious, *i.e.*, a breach of a promise which was specifically made to induce the purchase of securities where such purchase would not have been made but for that promise.[8] In this case, after the legislation had served its purpose as an inducement to purchase bonds and such bonds had been purchased, the legislation was repealed.

Appellees' attempt to draw a parallel between the instant situation and the situation facing bondholders of the Massachusetts Port Authority is patently absurd.

Appellees state:

> "Although the precedents holding all contracts, including those of the State, subject to the police power are indelibly clear, see pp. 65-75, *supra,* appellant, and *amicus* S.I.A. even more hysterically, claim that the consequences of applying this rule will be catastrophic. See, *e.g.,* Amicus Brief 4: 'A holding

8. See n. 4, page 5, *supra.*

> that the repeal legislation is valid would severely limit, if not foreclose, the access of municipal borrowers to the capital market. . . .' The claim is overwhelmingly refuted by the record.
>
> "The heart of appellant's contention is the assertion that the municipal bond market could not function if promises underlying bonds are subject to the reasonable exercise of the police power. The short answer is that it has always functioned this way."
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> "The Massachusetts Port Authority was born with an express judicial declaration that the provisions in its enabling act could be altered by subsequent legislation. See *Opinion of the Justices,* p. 75, *supra.*
>
> "On two subsequent occasions this reserved power was used and its use sustained over the objection that the changes would disadvantage bondholders.
>
> • • •
>
> "Despite this history of change and continuing vulnerability to change, Massachusetts Port Authority bonds are held in high regard by the investment community." App. Br. 77, 78, 79.

The obvious flaw in this argument is that unlike the situation here the Massachusetts legislature did not enact a specific piece of legislation for the acknowledged purpose of inducing investors to purchase bonds of the Massachusetts Port Authority, and then, after investors had purchased over a billion dollars of such bonds in reliance on the legislation, retroactively repeal it in order to do precisely that which was forbidden by the legislation.

In addition, appellees have either misread or misunderstood the decisions of the Supreme Judicial Court of Massachusetts which they cite. Although appellees state that the Massachusetts Port Authority "was born with an express judicial declaration that the provisions in its enabling act could be altered by subsequent legislation", App. Br.

77-78, citing *Opinion of the Justices,* 334 Mass. 721, 136 N.E.2d 223 (1956), in that case the Justices stated that the question of whether the state's subsequent alteration of the enabling legislation would violate the Contract Clause "is not susceptible of a very satisfactory answer without knowledge of what the 'subsequent legislation' might be." (136 N.E.2d at 236). The Justices continued:

> "In a general way we would answer the question 'No.' *** We are not, however, prepared to say that there could be no subsequent legislation of the types mentioned in the question that would in some manner constitute a violation of section 10 of art. 1 of the Constitution of the United States." (*Ibid.*)

The case of *Massachusetts Port Authority* v. *Treasurer & Receiver General,* 352 Mass. 755, 227 N.E.2d 902 (1967) is also inapposite since it deals solely with an "increase to some extent" of the annual operating expenses resulting from a change in the amount of credit for prior service of employees for retirement benefit purposes. The Justices said that such increase would not affect the security behind the bonds. It is clear from the decision that the number of employees involved and the amount of money involved was *de minimus,* thus fully supporting the Justices' decision.

The last authority cited by appellees, *Opinion of the Justices,* 313 N.E.2d 882 (Mass. 1974), is actually contrary to the arguments they urge to this Court. In that opinion, the Justices upheld the constitutionality of an amendment to the Massachusetts Port Authority's enabling legislation which limited the immunity from local property taxes previously conferred on its lessees. Unfortunately, appellees ignore the reasoning employed by that Court in reaching its conclusion:

> (a) the property tax exemption of the Authority's lessees contained in the enabling act (§ 17) *was neither an express nor implied term of the Authority's contract with its bondholders;*

> (b) § 17 could not be construed "as authorizing the Authority to enter contracts which would effectively abrogate the Legislature's reserved taxing power as to the Authority and the property it owns"; and
>
> (c) "purchasers of the Authority's bonds could [not] justifiably have relied on the continuation in perpetuity of the tax exemptions provided in the enabling act." 313 N.E.2d at 888.

Indeed, the Justices noted that "it is true that 'the sovereign power . . . may in certain conditions for the public welfare' enter into, or authorize a political subdivision to enter into, a binding contract of tax exemption which would be protected from repeal by the contracts clause. [citations omitted]." 313 N.E.2d at 888-889.

Finally—in language which dramatically points up the difference between the Massachusetts Port Authority situation and the repeal of the 1962 Covenant which was an express provision of the bondholders' contract—the Justices held:

> "To be distinguished is the Opinion of the Justices, 356 Mass. 775, 250 N.E.2d 547 (1969), in which we declared unconstitutional on contracts clause grounds a bill which would have barred the Massachusetts Turnpike Authority (Turnpike Authority) for a specified period of years from increasing the tolls charged for use of the Sumner and Callahan tunnels. See also Opinion of the Justices, 190 Mass. 605, 77 N.E. 1038 (1906). The Turnpike Authority had issued bonds which were secured by the revenues received from the tunnels. *The trust agreement securing the bonds expressly incorporated the provision of the Turnpike Authority's enabling act* that required tunnel tolls to be adjusted to ensure revenues sufficient to meet the bond obligations. 356 Mass. at 793, 250 N.E.2d 547 (1969). By the enabling act the bondholders were given a judicial remedy to compel the Turnpike Authority to perform its duties, 'including the fixing, charging and collecting of tolls.' St.1958,

c. 598, § 13. Thus, to permit the Legislature subsequently to forbid the adjustment of tunnel tolls '*would be a direct legislative repudiation of an arrangement which the 1958 statute empowered the Authority to make, going to the essence of the bond contract and materially reducing the attractiveness of the revenue security.*' 356 Mass. at 794, 250 N.E.2d at 557 (1969).

"As to the questions now before us, *no express provision of the bondholders' contract would be affected by House No. 5541, nor is there any legislatively authorized "arrangement"* of permanent tax exemption which would be repudiated by that bill." 313 N.E.2d at 890 (emphasis added.)

Actually, the Massachusetts decisions cited demonstrate that the Supreme Judicial Court of Massachusetts would have struck down an attempt by the Massachusetts' legislature to cynically repudiate a solemn pledge it had made to bondholders as an integral part of the contractual bargain.

IV

No Emergency Existed Sufficient to Justify the Impairment of the Covenant With Bondholders.

Home Building & Loan Ass'n v. *Blaisdell,* 290 U.S. 398 (1934) and its progeny firmly establish that impairment of a contract may be justified only if *essential* to solve an immediate *emergency.* Yet, appellees argue that impairment may be justified even if there is no emergency ("This Court's precedents also reject the contention that use of the police power must be based on emergencies or declarations thereof." App. Br. 82), and that an impairment can be justified merely if it serves a public purpose. ("The central question asks whether a valid public interest is being served." App. Br. 84).

The opinion in *Blaisdell,* and the facts upon which it was based, leave no doubt that the contract impairment there

was justified only in order to avert the imminent disaster caused by the emergency of the Depression. There was no contrived emergency in *Blaisdell.* In that case counsel for Mr. and Mrs. Blaisdell in the *Brief for the Appellees* filed in this Court stated: "We concede that in normal times and under normal conditions the Minnesota Mortgage Moratorium Law would be unconstitutional." He then went on to say "But these are not normal times and these are not normal conditions" (*Brief for Appellees,* p. 4), and detailed the facts underlying the emergency in the State which had brought about the passage of the Moratorium Law.

"For several months prior to the passage of the Mortgage Moratorium Act many serious breaches of the peace occurred from time to time throughout the state, especially in the rural districts, in connection with mortgage foreclosure sales, and in many instances *these sales were interrupted and prevented by mobs of people,* otherwise peaceful and law abiding, *who had been driven to desperation by the fear of losing their homes.* In some instances mobs comprising more than a thousand people gathered together and forcibly prevented the holding of foreclosure sales. These disturbances increased in violence and in number *until the Governor of the state, in the interest of preserving the public peace and the safety of the community, was compelled to and did issue an executive order directing sheriffs to refrain from foreclosing mortgages on homes until the legislature had an opportunity to pass a relief measure to cope with the emergency.*" Brief for Appellees, p. 7 (emphasis added).[10]

In *Blaisdell* this Court expressly predicated its holding on the finding of an emergency, *e.g.,* 290 U.S. at 444, and no

10. In the New York Times on April 30, 1933 the incipient insurrection in Iowa was reported as follows:

"Because a State judge refused to pledge himself to sign no more farm mortgage foreclosures, and rebuked the petitioners for their deportment in his courtroom, he was physically pulled off the bench, slapped and shaken, and, when he con-

(Footnote continued)

case decided before or after *Blaisdell* supports appellees' argument, App. Br. 82, that states may impair contract rights under the guise of the police power even in the absence of an emergency. Certainly, the two cases cited by appellees for the proposition do not so hold. *Gelfert* v. *National City Bank,* 313 U.S. 221 (1941), involved New York legislation which altered the prior method of determining the amount of a deficiency judgment after mortgage foreclosure and sale. In upholding the legislation this Court merely held that the ability of mortgagees to obtain more than payment in full *was not protected by the Contract Clause*:

> "Mortgagees are constitutionally entitled to no more than payment in full. *Honeyman* v. *Jacobs, supra.* They cannot be heard to complain on constitutional grounds if the legislature takes steps to see to it that they get no more than that. As we have seen, equity will intervene in individual cases where it is palpably apparent that gross unfairness is imminent."
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> "To hold that mortgagees are entitled under the contract clause to retain the advantages of a forced sale would be to dignify into a constitutionally protected property right their chance to get more than the amount of their contracts. *Honeyman* v. *Jacobs, supra.* The contract clause does not protect such a strategical, procedural advantage."
>
> • • •

(Footnote continued)

tinued to refuse, he was taken into the country for harsher treatment. His fortitude enduring, the enraged farmer put a rope around his neck, pushed him to his knees, smeared him with grease and mockingly crowned him with a hubcap in Plymouth County, Iowa, last wrenched from a truck * * *. For more than a year the normally peaceful and patriotic State of Iowa has been the most distressful farming region in the United States, but there was high feeling elsewhere against economic conditions that repaid the farmer's toil with foreclosure on his farmstead. In the cities the population had been miserable, too, but, contrary to the experience of most other countries, the mood for violence among usually orderly citizens was showing most clearly among the farmers."

> "As stated by this Court in [*Honeyman* v. *Hanan,* 302 U.S. 375, 378] the Federal Constitution does not prevent the states from determining, on due notice and opportunity to be heard, 'by what process legal rights may be asserted or legal obligations' enforced. The principles of those cases are applicable here. The fact that an emergency was not declared to exist when this statute was passed *does not bring within the protective scope of the contract clause rights which were denied such protection in Honeyman* v. *Jacobs, supra.* See *Home Building & Loan Ass'n* v. *Blaisdell, supra.*" 313 U.S. at 233, 234, 235 (emphasis added).

In *Viex* v. *Sixth Ward Bldg. & Loan Assn. of Newark,* 310 U.S. 32 (1940), this Court merely held that *emergencies* could be met by permanent legislation as well as temporary legislation; the case certainly does not stand for the proposition that a state may impair a contract in the absence of an emergency.

> "The cases cited in the preceding paragraph make repeated reference to the emergency existing at the time of the enactment of the questioned statutes. Many of the enactments were temporary in character. We are here considering a permanent piece of legislation. So far as the contract clause is concerned, is this significant? We think not. 'Emergency does not create [constitutional] power, emergency may furnish the occasion for the exercise of power.' We think of emergencies as suddenly arising and quickly passing. The emergency of the Depression may have caused the 1932 legislation, but the weakness in the financial system brought to light by that emergency remains. If the legislature could enact the legislation as to withdrawals to protect the associations in that emergency, we see no reason why the new status should not continue. When the 1932 act was passed commercial and savings banks, insurance companies and building and loan associations were suffering heavy withdrawals. The liquid portion of their assets were being rapidly drained off

by their customers, leaving the long term investments and depreciated assets as an inadequate source for payment of the remaining liabilities. An acceleration or a continuance of this tendency to withdraw available funds threatened a quick end to the ability of the institutions to meet even normal demands. Such threatened insolvency demands legislation for its control in the same way that liquidation after insolvency does. Such legislation may be classed as emergency in one sense but it need not be temporary."

• • •

"Certainly the protection of building and loan associations against the catastrophe of excessive withdrawal is, today, within legislative power." 310 U.S. at 39-40, 41.

Thus, in *Viex* the Court premised its holding on the imminent "catastrophe" of excessive withdrawals which would cause the demise of financial institutions of major importance to the credit system of the State.

Appellees' reason for arguing that contracts may be impaired to meet public purposes even in the absence of an emergency is obvious. Appellees recognize that the States of New Jersey and New York have not been faced with an "emergency" of a stature sufficient to justify not only the impairment of Port Authority bondholders' contracts but also the breaking of a solemn Covenant made by two sovereign governments for the purpose of inducing private investors to lend money for state purposes. Of course, appellees do not acknowledge as much; rather they make the hyperbolic argument that repeal was necessary because "physical, political [and] economic survival [was] at stake." App. Br. 96. This ludicrous exaggeration underscores the weakness of appellees' arguments. Surely, if the energy and pollution problems were true emergencies which threatened the physical, political and economic survival of New Jersey and New York, the legislatures of those

states would choose a more immediate measure than waiting for several years to improve mass transit in the narrow confines of the Port District. Indeed, they would have substantially raised gasoline taxes, automobile taxes or, given the reality of appellees' apocalyptic vision, barred automobile traffic. No such emergency measures were deemed necessary. The transit, energy and pollution problems are chronic difficulties, not emergency situations, and their causes and effects *cannot* be disposed of or handled on an emergency basis.

Moreover, even if these problems were of emergency proportion, appellees have failed to establish that repeal was *necessary* in order to avert a grave public injury or that the 1962 Covenant stood *directly* in the way of a solution to these problems. As noted in *amicus'* main brief, the common thread in all the cases in which this Court has upheld an impairment is the fact that the obligation impaired actually *directly* contributed to the emergency or *prevented* its solution. See, e.g., *Home Building & Loan Assn.* v. *Blaisdell, supra; Block* v. *Hirsch,* 256 U.S. 134 (1921); *W. B. Worthen Co.* v. *Kavanaugh,* 295 U.S. 56 (1935); *East New York Savings Bank* v. *Hahn,* 326 U.S. 230 (1945); *El Paso* v. *Simmons, supra.* Obviously, the 1962 Covenant did not directly contribute to the energy or pollution problems nor preclude a solution of these problems and appellees have not argued that it did.

Finally, it is clear that repeal of the 1962 Covenant was not, as required by *Blaisdell,* "appropriate" to meet the energy and pollution problems.[11] These problems cannot be

11. In *Blaisdell* this Court stated:

"In view of the nature of the contracts in question—mortgages of unquestionable validity—the relief afforded and justified by the emergency, in order not to contravene the constitutional provision, could only be of a character appropriate to that emergency and could be granted only upon reasonable conditions." 290 U.S. at 445.

solved, or even substantially alleviated, by the building or reconstruction of a few rail mass transit systems within the narrow confines of the Port District. It is not enough to justify a contract impairment to establish that the problems will, in some small way, be alleviated by such impairment. In other words, repeal of the 1962 Covenant was "inappropriate" because it was a case of over-kill in view of the modest results which could possibly be attained. The impairment cases cited above, from *Blaisdell* to *El Paso,* which are all predicated on the fact that the impaired obligation stood directly in the way of a solution to the emergency or directly caused the emergency, are not applicable and cannot serve as precedents in the instant case. Appellees problem is compounded by the fact, noted above, that they cannot even demonstrate that the impairment caused by repeal will significantly mitigate the energy or pollution problems. Indeed, given the serious adverse effect repeal will have, and has had, on the ability of New Jersey, New York and their agencies to market their obligations, repeal is not only ineffective but counter-productive.

Of course, notwithstanding appellees' contention to the contrary, in the instant case there was no legislative declaration of an emergency or of the Covenant's relation to any emergency or of the repeal's relation to the solution of any emergency. Even if there was such declaration, however, it would not have been conclusive but would have had to have been carefully scrutinized by this Court. As was stated in *Blaisdell:*

> "In these cases of leases, it will be observed that the relief afforded was temporary and conditional; that it was sustained because of the emergency due to scarcity of housing; and that provision was made for reasonable compensation to the landlord during the period he was prevented from regaining possession. The Court also decided that while the declaration by the legislature as to the existence of the emergency

> was entitled to great respect, it was not conclusive; and, further, that a law 'depending upon the existence of an emergency or other certain state of facts to uphold it may cease to operate if the emergency ceases or the facts change even though valid when passed.' It is always open to judicial inquiry whether the exigency still exists upon which the continued operation of the law depends. *Chastleton Corp.* v. *Sinclair,* 264 U.S. 543, 547, 548." 290 U.S. at 441-442.

Indeed, in a situation where the legislature is repudiating its own solemn pledge the normal deference given to legislative judgments should be reversed. Given their conflicting roles as both repudiating borrowers and judges in their own case, appellees should not be afforded the usual deference which is given to legislative determinations of public policy—which is founded on the recognition that, as a rule, a legislature occupies an impartial position, enabling it to mediate fairly between various interests.

In sum, no case has upheld the impairment of an obligation of contract in a non-emergency situation. Nor has any case upheld an impairment in an emergency situation unless (1) the impairment would significantly contribute to the solution of the emergency and, indeed, (2) was the *only* means of solving the emergency. These basic requirements are essential to the maintenance of continued confidence in the inviolability of contracts. After *Blaisdell,* for example, there was no reason for mortgagees to lose confidence in their mortgage contracts; they realized that their contracts would be enforced in the absence of a clear emergency. If the repeal of the 1962 Covenant is upheld, however, investors will have good reason to lose confidence in the integrity of their municipal bond contracts. The repercussions of this will obviously redound against the public interest.

Conclusion

The retroactive repeal of the 1962 Covenant was a politically motivated repudiation of a solemn pledge which should not be sanctioned by this Court.

Respectfully submitted,

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